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FUTURE OF SMALL BUSINESS

by

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FUTURE OF SMALL BUSINESS

S MALL BUSINESS, not generally faring so well as its big brothers in the present period of prosperity, received assurance of continuing government assistance in the closing hours of the first session of the 84th Congress. A bill to prolong the life of the Small Business Administration for two years, and to raise the limit on the size of individual loans by the agency from \$150,000 to \$250,000, received the final approval of both houses on Aug. 2 and was signed by President Eisenhower on Aug. 9.

As originally reported by the House Banking and Currency Committee, the bill would have doubled the lending authority of the Small Business Administration—from \$275 million to \$550 million—and otherwise expanded its powers. The Rules Committee, objecting to enlarging the agency's authority to that extent, refused to clear the bill for floor action. In modified form, however, the measure went through without dissent. Retention of a separate government agency devoted to the interests of small business had been recommended by the President, by the House and Senate Small Business committees, and by the Hoover Commission.¹

PURPOSE OF S.B.A.; DEFINITIONS OF SMALL BUSINESS

The Small Business Administration, set up by Congress on July 30, 1953, is the "first peacetime independent government agency created for the sole purpose of advising, counseling, assisting, and protecting the small business enterprises of the nation."² As such, it assumed the basic functions of the predecessor Small Defense Plants Administration and the small business loan functions of the Re-

¹ Opponents of a separate agency had contended that S.B.A. programs to aid small business could be taken over by other government departments. Several federal agencies, notably the Commerce Department and the armed services, engage in various activities in behalf of small business, but S.B.A. is considered the principal advocate of small business.

² *Small Business Administration—What It Is, What It Does* (pamphlet, December 1954), p. 1.

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construction Finance Corporation. The new agency also made federal assistance available to retail establishments, service enterprises, and manufacturing concerns not engaged in defense production.

Federal measures to aid small business date back to early New Deal days. An act of June 19, 1934, authorized Federal Reserve loans to business enterprises unable to obtain long-term credit elsewhere. The same act authorized the R.F.C. to make business loans, limited to \$100,000 each, to promote recovery and expand employment. The Smaller War Plants Corporation, created in mid-1942, offered small companies financial and other assistance to help them surmount difficulties of wartime operation;³ its functions were transferred after the war to the R.F.C. and the Commerce Department. The Small Defense Plants Administration was organized in 1951 to help small companies participate in production for the Korean war.

Established by the Small Business Act of 1953, the Small Business Administration was designed to fill at least part of the gap left by the simultaneous demise of the S.D.P.A. and the R.F.C. There was wide agreement at the time that the legitimate credit needs of small business could not be met entirely out of private financial resources. Congress therefore authorized S.B.A. to make loans, and to join banks in making loans, to small concerns otherwise unable to borrow.

The act defined a small business as "one which is independently owned and operated and which is not dominant in its field of operations." The Small Business Administration decided that, in general, a manufacturing firm (including affiliates and subsidiaries) that employed 250 or fewer persons would be considered small, and that one that employed more than 1,000 persons would be considered large. A manufacturing concern employing between 250 and 1,000 persons was to be treated as small or large according to size standards set for particular industries.⁴

In non-manufacturing fields dollar volume is used as the measure of size. In wholesaling a business whose annual sales do not exceed \$5 million is generally classified as

³ See "Revival of Small Business," *E.R.R.*, Vol. I 1945, pp. 206-213.

⁴ For example, in the scientific instruments industry small companies are those with 250 or fewer employees; in the machine-tool industry, those with 500 or fewer; and in the motor and generator industry, those with up to 1,000 employees.

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small; in retailing the sales limit is \$1 million; and in the service trades a small business is one with annual receipts of up to \$1 million. To determine whether a business is eligible to receive assistance in seeking government contracts, S.B.A. follows the general government practice of counting as small any company that employs fewer than 500 persons.

CONCERN IN CONGRESS FOR SMALL BUSINESS WELFARE

Despite rising general prosperity, the Senate Small Business Committee last March voiced concern over the position of little business. Noting in its "annual report" that 2,224 more business failures had occurred in 1954 than in 1953, the committee said that its appraisal of the situation provided no basis for a complacent view of the future of small, independent enterprises.⁵

The Senate committee pointed out that, computed as a percentage of stockholders' equity, profits after taxes of manufacturing companies with assets of less than \$250,000 had fallen from 10.6 per cent in the first half of 1952 to 4.1 per cent in the first half of 1954—a decline of 61.4 per cent; profits as a percentage of dollar sales had dropped 60.9 per cent. During the same period profits as a percentage of equity of manufacturing corporations with assets of more than \$100 million had risen from 11.3 per cent to 12 per cent—a 6.1 per cent increase; profits of the same corporations as a percentage of sales had climbed 10.5 per cent.

The committee concluded that the profit position of small manufacturing enterprises was "most disturbing." Together with other factors, the profit position strongly suggested that there were "obscure, complex, and underlying forces at work within our economy that are inimical to the future of small, independent enterprise." The committee's chairman, Sen. Sparkman (D-Ala.), told the National Retail Hardware Association in Buffalo, July 13, that the "widening gap" between the profit rates of the largest and smallest businesses indicated that the country's economic picture was out of balance.⁶

⁵ S.B.A. was able to report at the end of July that the number of failures had been slightly smaller in the first six months of 1955 than in the comparable period of 1954.

⁶ In the first quarter of 1955 earnings after taxes of small corporations were twice as large as they had been in the same quarter of 1954, but the profit picture still did not match that of large corporations.

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In its annual report on Mar. 30 the Senate Small Business Committee stressed again—as it had in previous years—that the “threat of monopoly . . . has . . . assumed more menacing proportions.” The semi-annual report of the Small Business Administration for the period ended Jan. 31, 1955, observed that “The current wave of mergers has resulted in the absorption of many small businesses into stronger entities, [thus] intensifying the competitive problem for the small businesses which have not been merged.”⁷ The S.B.A. report stated that “One of the ways in which small business may suffer the greatest injury . . . is by the invasion of a giant corporation into a field which has been characteristically dominated by small concerns and which is not germane to the larger concern’s main line of activity.”

Another aspect of the competitive relationship between large and small business has gained the attention of Congress. Some members have raised the question of whether small business will be able to follow the wage trends recently set by big business and big labor. Fear has been expressed that, if small companies are forced to pay constantly mounting wages, they may be squeezed out. Certain representatives maintained, in the recent House debate on increasing the statutory minimum wage from 75¢ to \$1 an hour, that small business could not absorb the rise.

PLACE OF LITTLE BUSINESS IN THE NATIONAL ECONOMY

More than 4 million, or 96 per cent, of the approximately 4.2 million businesses (excluding farms and professional offices) in the United States are small business enterprises. The small business segment of the national economy accounts for about 40 per cent of all goods and services and employs 40 per cent of the labor force. Small business has played an important role as a subcontractor in defense programs. During the Korean war, for example, it was estimated that more than 52,000 of the 60,000 subcontractors and suppliers in aircraft manufacturing were small companies. “The small business is the economic seed bed from which rises the majority of new ideas, new methods, and inventions.”⁸

The social and political importance of small business is axiomatic. The Senate Small Business Committee asserted

⁷ See “Business Mergers,” *E.R.R.*, Vol. I 1955, pp. 97-115.

⁸ Chamber of Commerce of the United States, *Small Business: Its Role and Its Problems* (1954), p. 13.

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last spring that the four million small business units formed "the basis of our progressive economy." The committee went on to say: "That they perform this foundational function is owing entirely to freedom of competition. . . . It follows that any force which unnaturally restricts freedom of competition is bad and any . . . force which promotes and encourages free competition is good."⁹

The ideal of pure competition among large numbers of small enterprises has long been identified with American business concepts. *Fortune* magazine has observed that the small business "problem" has become "one of the great and continuing themes of American politics." Noting that it was "obvious, not just in politics but also in equity, that small business deserves 'a fair chance,'" *Fortune* said: "Less obvious are the practical problems of small business, and the course that government should take to relieve them."¹⁰

Problems Facing Small Businessmen

THE PROBLEMS that confront small business are numerous and ever-present. Despite the fact that its economic position has improved somewhat since last spring, the problems that have faced small business in the past continue to do so. Tapping the equity capital market is difficult. Management deficiencies may stand in the way of efficient operation. High taxes raise an obstacle to accumulation of capital.¹¹ Expansion may be impeded by inability to conduct product research or diversify production. Yet small concerns still must carry inventories and maintain modern equipment and facilities if they are to hold their own with larger competitors.

DIFFICULTIES OF OBTAINING SATISFACTORY FINANCING

Among the major complaints voiced by small businessmen at congressional hearings, the difficulty of financing, especially of obtaining equity capital and long-term credit,

⁹ Attorney General Brownell told the Small Business Administration's National Council of Consultants, July 14, that "Consideration for the welfare of small business is basic to antitrust philosophy."

¹⁰ "Does 'Small Business' Get a Fair Shake?" *Fortune*, October 1953, p. 164.

¹¹ "There is wide agreement, amounting to doctrine, that taxation, management, and finance together form an interrelated triumvirate of small business problems."—*Ibid.*, p. 164.

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is the "most persistent."¹² Unlike large corporations, which usually can raise all the new capital they need by selling stock, small companies find it very hard to raise funds in that manner. The operation, moreover, may be extremely costly. It has been said that commissions and other expenses entailed in marketing a securities offering of \$300,000 or less may run as high as \$100,000.¹³

In contrast, multimillion-dollar securities issues may be floated for as little as six per cent of the gross proceeds. The Federal Reserve Board has pointed out that "The securities markets are best suited for large flotations of nationally known firms and, for all practical purposes, cannot be used effectively by small localized companies." The board noted that "Availability of long-term debt and equity capital to small business has tended to diminish somewhat over the past two or three decades."¹⁴

Traditionally, therefore, the equity capital used by small business has come from the owners' accumulated savings or from wealthy individuals in the community. But rising taxes, increased costs, and keener competition have depleted savings, while local investors have come to prefer government bonds, building and loan association shares, or securities of large corporations. Consequently, most young men who wish to enter business must be "grubstaked."¹⁵ In a statement submitted to a Senate Banking and Currency subcommittee on May 4, Sen. Thyne (R-Minn.), former chairman of the Senate Small Business Committee, said:

With the present high taxes and the high standard of living in our society, with the modern conveniences which are actually necessities these days . . . young people especially find [that] demands upon their earnings deny them the opportunity of saving enough to permit them to have the necessary funds to acquire business of any kind. Without sufficient collateral the local banks, because of restrictions imposed by both state and federal governments, are often . . . unable to advance the necessary funds to permit these young couples . . . to . . . acquire a business of their own.

¹² *Ibid.*, p. 164. It is indicated that the problem of finding equity capital has eased up to some extent in recent months.

¹³ Figures cited in "Small Business: Its Problems," *Nation's Business*, April 1954, p. 63. Offerings under \$300,000 are exempt from Securities and Exchange Commission registration. See "Protection of Investors," *E.R.R.*, Vol. I 1955, p. 49.

¹⁴ Board of Governors of the Federal Reserve System, *The Cost and Availability of Credit and Capital to Small Business* (staff report submitted to monopoly subcommittee of Senate Small Business Committee, Oct. 30, 1952).

¹⁵ Business loans to World War II and Korean veterans under the various "G.I. Bills," which carried a 50 per cent guarantee by the Veterans Administration, numbered 220,599 at the end of May 1955. The loan amount totaled \$597.3 million; the individual loan averaged \$2,706. The V.A. had paid out \$9.8 million under the guarantee clause on 12,529 loans, but that outlay was subject to at least partial recovery.

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Inasmuch as small firms do not have as ready access to the capital market as large companies, they must rely mainly on borrowing when they need money. But available loans are usually for short terms and, according to the Small Business Administration, "The need today seems to be largely for long-term capital to purchase fixed assets rather than for short-term capital for operating purposes."

The House Small Business Committee reported on Dec. 28, 1954, that current tax rates had acted as a "major deterrent to an improved competitive status for small business enterprises." Many small companies, the House committee said, had been unable to "retain sufficient earnings after taxes to finance necessary expansion." Lack of such capital placed "undue emphasis on longer-term borrowing which in itself has been difficult to obtain."

Several changes last year in the federal income tax laws promised to be of assistance to small business. Benefits were anticipated primarily from liberalization of depreciation provisions. Provisions applying to deduction of research and experimental expenditures, to loss carryovers, and to accumulation of funds also were liberalized. Expiration of the excess profits tax on Jan. 1, 1954, likewise helped certain small business enterprises. Passage of a pending bill, introduced July 28, 1955, by Sen. Fulbright (D-Ark.), to exempt the first \$15,000 of corporation income from taxation would be of particular advantage to small incorporated businesses.

DROP IN GOVERNMENT CONTRACTS FOR SMALL BUSINESS

Transition from a limited war economy in the period of Korean hostilities to a defense-production economy brought about many changes in government purchasing policies and substantial reductions in total Defense Department procurement. The Senate Small Business Committee, in a report on military procurement July 30, observed that "Small business has been receiving less in terms of prime contract dollars generally . . . and, more disturbing, the percentage of contract awards considered to be within the area of small business accomplishment has also been on the decline."

According to figures cited by the committee, the total net value of military prime contract awards dropped from \$41.2 billion in the year ended June 30, 1952, to \$11.5 billion in fiscal 1954, and awards to small business declined over the

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same period from \$7.1 billion to \$2.9 billion. The committee noted that although 25.1 per cent of total awards went to small firms in fiscal 1954, "The best estimate available is that during fiscal 1955, approximately 20.8 per cent . . . will go to small business." The proportion of prime contracts regarded within the capacity of small business dropped from 35.1 per cent of the total dollar volume in fiscal 1954 to 31.8 per cent in the first nine months of fiscal 1955.

Subcontracting is the chief source of defense business for many small concerns, but the value of subcontracts appears to have declined out of proportion to the drop in total defense procurement. The Small Business Administration has noted that many prime contractors are tending more and more to do the work in their own plants or in those of their subsidiaries or affiliates. Factors contributing to curtailment of subcontracting include changes in types of production and production schedules; high overhead and plant maintenance costs incurred by large prime contractors; and a desire to keep government-owned equipment in maximum use to avoid its withdrawal.

PENTAGON PREFERENCE FOR PURCHASES BY NEGOTIATION

One impediment to letting government contracts to small business is said to be a preference by the Defense Department for arranging purchases by negotiation instead of competitive bidding. The Small Business Administration has asserted that "The preference for the negotiated method of purchasing unquestionably reduced the volume of possible contracting with small enterprises . . . [which] receive their fullest and most equitable opportunity to participate in government procurement under formal advertising procedures."¹⁸

The S.B.A. has alleged that negotiation was utilized in more than 90 per cent of all procurement actions in fiscal 1954, and the Senate Small Business Committee has asserted that since 1950 around 90 per cent of the dollar value of all purchasing has been handled by negotiation. Thomas P. Pike, Assistant Secretary of Defense for Supply and Logistics, testified before a Senate Small Business subcommittee on Apr. 20 that "Use of negotiation in cases where it is now authorized by policy is functioning, as a practical matter, in a way that is in the best interests of the taxpayer

¹⁸ S.B.A., *Third Semiannual Report* (Mar. 18, 1955), pp. 23-24.

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and of the national defense and at the same time is not adverse to the interests of small business."

Inasmuch as negotiation for any one contract is carried on with several companies, some competition exists under that method of procurement, but it is generally accepted that advertising for bids stimulates competition and generally results in lower prices. The Armed Services Procurement Act and the Federal Administrative Service and Property Act, which prescribe rules for government purchasing, establish competitive bidding as the preferred method of contracting, but they allow exceptions that permit widespread purchasing through negotiated contracts.

The major exception listed in the Armed Services Procurement Act stipulates that "Purchases and contracts may be negotiated by the agency head without advertising if . . . determined to be necessary in the public interest during the period of a national emergency declared by the President or by the Congress." Constantly expanding use of that exception by various federal agencies was criticized by the Senate Small Business Committee last March. In a more recent report, July 30, the committee still was of opinion that there was an "indiscriminate use of the power of negotiation"; it was "not convinced that there is a genuine desire on the part of procurement officials to make a real attempt to expand the area of advertised contracting."

INADEQUACY OF MANAGEMENT AND RESEARCH RESOURCES

The most serious problems of many small concerns arise, not from a lack of capital or of government contracts, but from an insufficiency of management and technical skills. Under modern competitive conditions, the small business firm requires managerial personnel skilled in several fields. But small companies are not in financial position to take on the number or variety of high-priced experts that large corporations can employ. Unlike a big firm, moreover, the small company rarely can afford to call in outside experts.

Most studies of the reasons for failure of small businesses have found the main cause to be poor management. Wendell B. Barnes, head of the Small Business Administration, has said that "Of the 306,000 businesses which go out of existence in this country every year, roughly 40 per cent fail or cease to exist because of lack of managerial ability and

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failure to make proper decisions."¹⁷ According to a recent Dun and Bradstreet survey, 49 per cent of the business failures in the year ended June 30, 1954, were due to "incompetence," 18 per cent to "unbalanced experience," 12 per cent to "lack of managerial experience," and 10 per cent to "lack of experience in line."¹⁸

Most small firms find it almost impossible, moreover, owing to limited facilities, to develop or launch a new product. Plants in which the owner alone supervises production, runs the business office, and handles daily details are unable to conduct effective research on development of new processes and products. Such plants consequently are hampered in competing with those that can afford to carry on technical and marketing research. The needs of many small firms are typified by the following request for assistance received by the Small Business Administration:

Our company has developed an aluminum carport and is about to launch a marketing program for this product. However, before we do so, . . . we would like to know the total number of homes, exclusive of farm homes, . . . in the United States; the number of homes constructed . . . since the end of World War II; whether the trend in carport construction is increasing or decreasing; and the number of homes . . . with garages, as well as the number . . . with carports.¹⁹

Compared with his larger competitor, the small businessman is at a disadvantage in respect to his relations with federal agencies. Thurman Arnold once described a small business as one that had no Washington office. The ordinary small business cannot possibly afford to maintain a representative in Washington. At the same time, the requirements imposed by a multitude of federal regulations put a heavy burden on small business.²⁰

The Senate Small Business Committee, in its annual report last March, said it was disturbed by "ample indications that small businessmen who find themselves embroiled with federal executive agencies do not always receive equitable treatment." The committee commented that "In the case of some Post Office Department mail-fraud proceedings and Federal Trade Commission cease-and-desist orders, the

¹⁷ Quoted in *Nation's Business*, April 1954, p. 62.

¹⁸ *Dun's Review*, October 1954, p. 57.

¹⁹ Small Business Administration, *Products Assistance Program* (pamphlet, February 1955), p. 3.

²⁰ The report of a Hoover Commission task force on *Paperwork Management*, released July 17, scored the vast number of federal regulations that have "swamped" the small businessman.

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probability exists that small businessmen are frequently accorded treatment which runs counter to accepted canons of fair play."

Federal Efforts to Help Small Business

THE Small Business Administration is not authorized to provide venture capital—that is, the major portion of the capital needed to start a new business—but it is empowered to make loans to aid small firms in numerous other ways.²¹ Its Loan Policy Board—composed of the S.B.A. Administrator and the Secretaries of the Treasury and Commerce—has declared that it is the policy of S.B.A. to "assist reliable, capable businessmen operating small firms to secure necessary credit for constructive purposes on terms that will meet the borrower's individual requirements." The S.B.A. will make loans to small business enterprises only when credit is not otherwise available to them on reasonable terms.²² It does not compete—but on the contrary cooperates—with banks and other private lending agencies.

PROCEDURE FOR OBTAINING SMALL BUSINESS LOANS

A small businessman who needs to borrow money must try first to obtain a loan from a local bank or other lending institution. If the bank is not willing to lend the entire amount, the businessman must ascertain whether it will make a loan in participation with S.B.A. on either a deferred or immediate basis.²³ If the local lending institution declines to extend a loan on any basis, the businessman then may apply for a direct loan to be made entirely by S.B.A.

²¹ Sec. 207(a) of the Small Business Act of 1953 authorized loans to "enable small business concerns to finance plant construction, conversion, or expansion . . . ; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital." Congress to date has made available only \$125 million of the \$275 million authorized for loans.

²² S.B.A. will not make loans: (1) If funds can be obtained through disposal of an applicant's personal assets or through loans from other government agencies that extend credit specifically for the applicant's type of business; (2) if the loan is to pay off creditors or finance recreational facilities; (3) if the applicant is a newspaper, magazine, or broadcasting company; (4) if the applicant's income is derived from gambling or sale of alcoholic beverages; (5) if the effect of granting the loan would be to encourage monopoly.

²³ A deferred participation loan is one in which a private lending institution advances the capital and S.B.A. agrees to buy, on ten days' notice, an agreed portion of the unpaid balance. An immediate participation loan is one in which S.B.A. or the private lender agrees to purchase from the other, immediately upon disbursement, an agreed percentage of the loan. S.B.A. will not agree to immediate participation if deferred participation can be arranged.

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The "practical credit requirements" that S.B.A. has established for either participation or direct loans stipulate that an applicant must have enough capital in the business so that, with the aid of the loan, the enterprise can be operated on a sound financial basis. Moreover, the loan must be "of such sound value or so secured as reasonably to assure repayment." And the past record and future prospects of the business must show sufficient probable income to assure repayment.

Under the Small Business Act of 1953, as amended, Aug. 9, 1955, the maximum amount that S.B.A. may loan to any borrower, directly or as its share of a bank loan, is \$250,000. The amended act not only raised the individual loan maximum from \$150,000 to \$250,000 but also authorized group loans in larger amounts. If several small concerns form a corporation "to produce or secure raw materials or supplies," that corporation may borrow an amount equal to \$250,000 multiplied by the number of participating small businesses.

NUMBER AND DISTRIBUTION OF S.B.A. BUSINESS LOANS

By June 30, 1955, the Small Business Administration had approved 1,645 business loans in an aggregate amount of nearly \$84 million. Up to Jan. 31, latest date for which detailed statistics are available, S.B.A. had received 4,312 applications for business loans, had approved 1,166 (775 participation and 391 direct) for a total of about \$61.7 million, and had turned down 2,056 applications.^a Nearly half the disapprovals were due to the fact that the applicant's earning ability had not been convincingly demonstrated.

Of the 1,166 loans approved, the largest group — 326 loans or 28 per cent—consisted of advances ranging from \$25,000 to \$50,000. About 54 per cent of the loans went to manufacturing concerns and the remainder to service, wholesale, and retail enterprises. More than 88 per cent of the loans to manufacturers were to companies with fewer than 100 employees; 92 per cent of the loans to non-manufacturers were to companies with annual sales under \$1 million.

The S.B.A. lending program has been criticized on the one hand as too limited and too slow-moving and, on the

^a 717 applications had been withdrawn; 373 were still pending on Jan. 31.

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other hand, as unnecessary. The Senate Small Business Committee has pointed out that the credit wants of small firms are "usually urgent"; if a loan that is needed to take advantage of a business opportunity is not forthcoming promptly, the opportunity may be lost and "the small firm will have been found wanting in its financial strength."

A House Small Business subcommittee asserted, July 1, that the lending program was "not being adequately administered" and that processing of loan applications had been "overcautious." Rep. Patman (D-Tex.), chairman of the Small Business Committee, has said that information furnished S.B.A. never seems to be sufficient. He indicated on July 26 that he would arrange a committee investigation of the agency's lending practices. S.B.A. tried last year to speed processing of applications by authorizing its regional offices to approve loans of up to \$50,000 in which local banks had at least a 25 per cent participation. Further decentralization of authority took place in July 1955 when the regional offices were given power to approve direct loans of up to \$10,000.

The Conference of American Small Business Organizations, which has questioned the need for a separate agency to aid small business, asserted in a statement submitted to a Senate Banking and Currency subcommittee on May 11 that S.B.A. was not filling the financing gap it was intended to fill. The group was critical of the fact that so few loans had been made to new businesses and so few to non-manufacturing enterprises, which account for the bulk of small businesses. Pointing out that the number of loan applications was "microscopic in proportion to the number of small businesses in the country," the statement called the number of loans approved "absurdly nominal." It concluded that "The quantitative benefits of S.B.A. to the total world of small business are so small as to be difficult to judge statistically."

The Hoover Commission's task force on lending agencies, though not the commission itself, recommended that S.B.A. lending activities be "completely discontinued and the [Small Business] Administration . . . eliminated." The task force was of the opinion that "The scope of S.B.A. lending authority is so limited at present that funds could not possibly be provided for all of the borrowers who could qualify, and accordingly many of them must, and do, get along without government assistance." Therefore, the task

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force reasoned, "If those who must get along without assistance can do so, it would seem to follow that the same could be required without too much hardship of those who are fortunate enough now to be selected as successful applicants." *

HELP FOR SMALL BUSINESS ON DEFENSE CONTRACTS

The Small Business Administration has initiated several programs to carry out the policy, given expression in the Small Business Act, of placing with small firms "a fair proportion of the total purchases and contracts" for government supplies and services. The Senate Small Business Committee has observed that efforts to guarantee small concerns a fair share of military procurement are justified because (a) the military establishment is the country's biggest customer, (b) the continued vitality of small business might mean the difference between victory and defeat in an all-out emergency, and (c) inclusion of small firms among bidders for government contracts often intensifies competition and assures favorable prices for the government.

S.B.A.'s main instrument for increasing the share of defense business going to small firms is the "joint determination program," which was begun by the Small Defense Plants Administration and the armed services during the Korean emergency. Under this plan, representatives of S.B.A. and the Defense Department review prospective military purchases, other than classified and emergency procurements, to determine which ones shall be set aside for exclusive award to small business enterprises. From August 1953, when the Small Business Administration came into existence, through June 1955, S.B.A. proposed nearly 6,000 joint determinations. The armed services agreed to most of them, with the result that in that period about 5,000 contracts valued at approximately \$300 million were awarded to small concerns.

S.B.A. representatives, assigned to major military procurement centers, can only recommend, not insist, that orders be placed with small firms. Success of the joint determination program depends, therefore, on cooperation between S.B.A. and military procurement officials. The Small Business Administration said in its latest report that "ex-

* Hoover Commission Task Force on Lending Agencies, *Report on Lending Agencies* (February 1955), pp. 71-72.

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cellent relationships" existed in most purchasing offices. It cited as evidence the fact that only 3.3 per cent of the number of joint determinations it had initiated in the period from Aug. 1, 1954, through Jan. 31, 1955, had been rejected, as compared with 21.4 per cent rejected in the comparable period a year earlier.²⁸

The joint determination program has gained in effectiveness since March 1954, when the Defense Department issued new instructions in connection with the matter. Assignment of an S.B.A. liaison officer to work in the Defense Department also contributed to closer cooperation between the two agencies.

The Senate Small Business Committee reported July 30 that it had found within the Defense Department during the past year "encouraging signs" of a recognition of the role of small business in military procurement. The committee was of the opinion that while "there are still those within the military departments who would rather not have to put up with the small business program . . . these near-sighted people are in a distinct minority." Six months earlier, the House Small Business Committee had noted "marked improvement" but observed also that "Residual opposition to joint determination is undiminished in many procurement offices." The House committee recalled numerous instances "illustrative of the resistance which has characterized the attitude of the Department of Defense toward [S.B.A.] efforts . . . to create a meaningful program of genuine assistance" to small business.

CERTIFICATES OF COMPETENCE FOR SMALL CONCERNS

S.B.A. helps to increase the small business share of defense contracts, not only through operation of the joint determination program, but also through issuance of "certificates of competency." Small companies thereby may be enabled to obtain prime contracts for which they would otherwise not be deemed qualified. When a procurement officer hesitates to grant a contract to a small firm—even though it is the low bidder—because he has doubts about its ability to produce, S.B.A. upon request makes an investigation of the company's facilities, management, and finan-

²⁸ Main reason for rejections, the S.B.A. reported, was an "unwillingness to restrict entire procurements to small firms if it is believed that large firms might bid slightly lower." According to the House Small Business Committee, contracting officers have cited as justification for rejections the difficulties caused by production failures of certain small firms.

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cial resources. If its findings are satisfactory, it certifies that the company is competent as to credit and capacity to produce.

Once a certificate of competency has been issued, procurement officers are required by the Small Business Act to accept it as conclusive so far as financial and technical matters are concerned. Since its establishment the Small Business Administration has granted more than a hundred certificates of competency, and they have resulted in contract awards of over \$12.5 million.

REFERRAL PROGRAMS; COOPERATION OF OTHER AGENCIES

S.B.A. conducts a "prime contract referral" program under which its field offices review bid application forms, drawings, and specifications put out by purchasing offices, to determine whether small companies in the respective areas might supply the items to be purchased. Firms capable of doing so are then notified, so that they may bid for the business.⁷ Such notifications, totaling in excess of 254,000 to date, led in the period from July 1954 through July 1955 to the award to small concerns of some 3,100 contracts valued at more than \$250 million.

The Small Business Administration directs the attention of prime contractors to qualified small companies in an effort to induce the "primes" to place more subcontracts with small firms. However, only 329 subcontracts, aggregating about \$5.6 million, were on record up to last January as having resulted from this program. S.B.A. believes that many small firms have failed to inform it of subcontracts they have received, but the Senate Small Business Committee maintained in its report of Mar. 30, 1955, that S.B.A. had "not devoted a sufficiently large share of its attention to the procurement field in general and to the subcontracting area in particular."

Both the subcontracting and the prime contract referral programs are made possible by maintenance in each S.B.A. regional office of an inventory of the production facilities of small companies in the area. The facilities inventory is designed for use also in the event of full mobilization. By last January 27,125 small plants had registered with

⁷Sec. 207 of the Small Business Act authorizes S.B.A. itself to act as a prime contractor and subcontract work to small plants. Seven prime contracts obtained by the Small Defense Plants Administration were transferred to S.B.A. for administration on Nov. 30, 1953. The prime contracting program at present is in standby status.

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the S.B.A.; plans are under way to increase the number to 100,000.

The Defense Department tries to increase subcontracting opportunities for small business by including in most of its contracts a clause requiring the contractor to subcontract to small firms the "maximum amount that . . . [he] finds to be consistent with the efficient performance of his contract." But Assistant Defense Secretary Pike conceded before the Senate Small Business Committee, Apr. 20, that this provision had "no real teeth in the sense that there are legal sanctions . . . in it." However, Pike told the committee that, under a new Defense Department policy, prime contractors receiving contracts in excess of \$1 million would be "urged" to set up "defense subcontracting small business programs." Those programs would be designed, he said, to give small concerns a "fair competitive chance at defense subcontracts."

S.B.A. has various procurement agreements with government agencies other than the Defense Department, such as the Post Office Department, the Atomic Energy Commission, the International Cooperation Administration (formerly Foreign Operations Administration), and the General Services Administration. The agreements range from provisions for supplying the agencies with names of small firms for their bid lists to programs involving the joint determination and certificate-of-competency procedures.

FINANCIAL, MANAGEMENT, AND TECHNICAL ADVICE AND AID

In addition to offering small business such direct aid as loans and procurement assistance, S.B.A. provides advisory services in the financial, production, and management fields. Specialists in S.B.A. regional and branch offices try to find ways to enable small companies to solve financial problems without resort to borrowing. When outside funds are essential, however, the specialists help in preparation of an effective request for funds and sometimes in the search for prospective lenders. To assist small firms in obtaining accelerated tax-amortization benefits on new plant or equipment, S.B.A. intercedes in their behalf with the Office of Defense Mobilization.

One important type of production assistance that S.B.A. renders is to locate certain kinds of scarce materials and equipment needed by small concerns. It also represents

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small firms before other government agencies that have control over such items. For example, it may help a small company to acquire surplus government-owned machine tools, or it may intervene with the Business and Defense Services Administration to enlist its assistance in obtaining release of a scarce mineral needed to keep a small plant in operation. S.B.A. experts also advise small firms on technical production matters and on problems of plant space.

Under its product assistance program the agency serves as a clearing house for information on product development, improvement and marketing. It does not itself give technical advice on product development, but it provides information developed by government, university, and industrial laboratories. S.B.A. maintains a register of products and inventions whose owners have made them available for development or distribution and a register of manufacturers interested in finding new articles to produce. Other S.B.A. activities to aid the small businessman include publication of leaflets and booklets on management and technical subjects and compilation of purchasing and specifications directories.

